



NEW HAMPSHIRE RETIREMENT SYSTEM

Management Letter
and

Auditors' Report on Internal Control Over Financial Reporting and
Compliance and Other Matters Based on Audit of Financial Statements Performed
In Accordance With
Government Auditing Standards

Year Ended June 30, 2004



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MANAGEMENT LETTER

November 8, 2004

The Fiscal Committee of the General Court:

We have audited the financial statements of the New Hampshire Retirement System (the System) for the year ended June 30, 2004 and have issued our report thereon dated November 8, 2004. In planning and performing our audit of the financial statements of the System, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

A material weakness is a reportable condition in which the design or operation of specific internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve the internal control structure or result in other operating efficiencies and have been summarized below.

Technology Update Project

The System continues to focus on Phase 1 of the technology update project. During the fiscal year ended June 30, 2004, several components of the new technology upgrade began to be utilized that affect information presented in the financial statements and therefore we supplemented our audit procedures with a limited review of the security features around those components. While performing our security evaluations we were presented with a variety of concerns expressed by management around data security, integrity and the ability to reconcile data between various departments within the System. As a result we expanded our security review to evaluate managements concerns and the potential impact of these on the 2004 financial statements. We were able to perform additional substantive audit procedures to gain comfort with the information presented at the financial statement level, however, the operational concerns expressed by management corroborated by the expanded security review procedures and reinforced by our 2004 audit procedures highlighted several areas of concern:

- The lack of security around the interface between the System and employers.
- The lack of controls around changes being made to information converted from the legacy system



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New Hampshire Retirement System

- The significant amount of time, effort and manual manipulation required by employees to obtain the information necessary to perform their assigned function.
- Difficulty in performing timely reconciliations between the general ledger and individual member accounts.
- Difficulty in timely identifying deceased members.

Management is keenly aware of the importance of this new technology platform and its successful completion on the future of the System and is diligently allocating resources to address these and other issues. However, at this critical point in the technology update process, we believe it would be appropriate to re-evaluate the process of identifying issues the System is encountering during this technology upgrade, how these issues are prioritized and how resources are allocated to address these issues.

Management's Response:

The NHRS management is keenly aware of the importance of addressing the system security and data integrity issues related with the new system and will deploy adequate resources to fully address these issues in the coming months. More specifically, the NHRS management plans to address the areas of concern expressed in the audit comment as follow:

- The NHRS will work with the vendors to identify and cost out the appropriate methods for securely transmitting the files electronically through the interface between the new system and the employers.
- The NHRS will develop a plan to work with the line of business managers to identify controls, if needed, for the data changes made to the converted data from the legacy system by utilizing adequate audit trails and 'notes' function. Furthermore, these controls will be prioritized and implemented as needed.
- The NHRS will develop a plan to work with the line of business managers to identify the areas that require data manipulation and will streamline the procedures and reports by business process redesign and enhancements to the system or other alternative solutions.
- The NHRS already has requested redesigned PensionGold reports and Crystal reports to facilitate timely reconciliation of the general ledger with the member accounts. Once these reports are completed it will streamline the general ledger reconciliation process.
- The new system, similar to the old system, has the capability of creating a death verification file. The IT Director will work with the Annuity Administrator to ensure that staff is properly trained in creating the death verification file for updating the system on a periodic basis.

The NHRS feels confident that the above referenced actions will adequately address the data integrity and security issues related with the new system.



New Investment Disclosure Standards

In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures*. GASB 40 requires communication of key information in the financial statements about deposit and investment risks covering four principal areas:

- 1) Investment credit risk disclosures, including credit quality information issued by rating agencies;
- 2) Interest rate disclosures that include investment maturity information, such as weighted average maturities or specific identification of the securities;
- 3) Interest rate sensitivity for investments that are highly sensitive to changes in interest rates (e.g., certain variable-rate investments and asset-backed securities); and
- 4) Foreign exchange exposures that would indicate the foreign investment's denomination.

The provisions of GASB No. 40, which will supersede the custodial credit risk disclosures currently required by GASB No. 3, are effective for the System for fiscal 2005. We believe the assessment of information relative to debt instruments will be the most burdensome compliance aspect, and that compilation of the underlying data will require the up-front involvement of investment custodians. We encourage the System to consider the guidance contained in the Implementation Guide recently issued by GASB to help develop a comprehensive implementation plan.

Management's Response:

As mentioned in the audit comment, the NHRS is planning to develop a comprehensive implementation plan for the GASB No. 40 implementation for the fiscal year ended June 30, 2005. The implementation plan will fully address the deposit and interest risk disclosures, and will outline a plan for drawing on available resources from the System's custodial bank and the investment consultants to adequately address the disclosure requirements for credit risk, interest risk, and foreign exchange risk related to the System's investments.



STATUS OF PRIOR YEAR COMMENTS

Following is a summary of the status of corrective actions taken to date on comments and recommendations appearing in our 2003 management letter. For your convenience, we have summarized each comment and recommendation and included management's updated and final responses.

Interest Paid on Non-Vested Member Accounts

We recommend the System re-evaluate the current policy of allowing individuals six years from the date of separation to find an investment alternative for their contributions and establish an interest rate to be paid on non-vested terminated member accounts that is consistent with market alternatives that have similar risk profiles.

Management's Response:

The NHRS is pursuing proposed legislation filed for the 2005 legislative session that will fully address this audit observation. The proposed legislation will amend RSA 100-A:11 to decrease the number of years from six to up to two years that an inactive non-vested member may be allowed to leave the accumulated contribution balance with the NHRS after the termination of service with the participating employer.

* * * * *

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the New Hampshire Retirement System and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

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**Auditors' Report on Internal Control Over Financial Reporting and
Compliance and Other Matters Based on Audit of Financial Statements Performed
In Accordance With
*Government Auditing Standards***

The Fiscal Committee of the General Court:

We have audited the financial statements of the New Hampshire Retirement System (the System), as of and for the year ended June 30, 2004, and have issued our report thereon dated November 8, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving internal control over financial reporting, which we have reported to management of the System in a separate letter dated November 8, 2004.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of the management of the New Hampshire Retirement System and the Fiscal Committee of the General Court and is not to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 8, 2004